

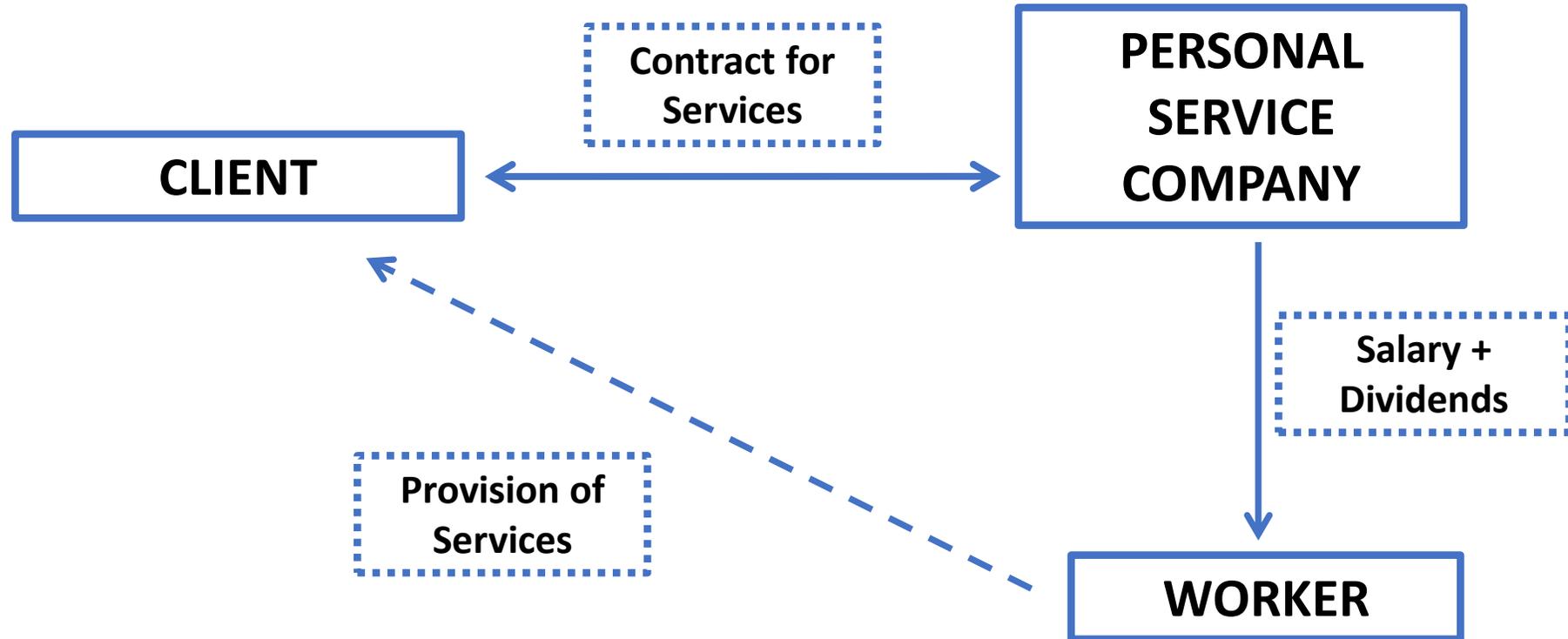
PUMP COURT
TAX CHAMBERS

INTERMEDIARIES LEGISLATION (IR35)

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1st October 2020

Common Structure



Tax Burden – Basic Rate Tax Payer

	Employment Income	Dividends
Income	100	100
Employer's NIC (12.85)	11.35	
Income Tax (20%)	17.73	
Employee's NIC (11%)	9.75	
Corporation Tax (21%)	0	21
Dividend Tax (10% subject to 10% credit)	0	7.9
Total Tax	38.83	28.9

Background – IR35

- 9 March 1999 – Budget press release IR35 – ‘Countering Avoidance in the Provision of Personal Services’
- April 2000 – FA 2000, Schedule 12 – ‘Provisions of Services through an Intermediary’
- ITEPA 2003 – consolidation in Chapter 8 Part 2 – ‘Application of Provisions to Workers under Arrangements made by Intermediaries’
- 6 April 2007 - Chapter 9 Part 2 ITEPA 2003 – ‘Managed Service Companies’ – takes priority over Chapter 8

Background

- **6 April 2007** - Chapter 9 Part 2 ITEPA 2003 – ‘Managed Service Companies’ – takes priority over Chapter 8
- **6 April 2017** – Chapter 10 ITEPA 2003 – ‘Workers’ Services provided to public sector through Intermediaries’ – takes priority over Chapters 8 and 9
- **July 2019** – Finance Bill 2019-20 including amendments to the Intermediaries Legislation to take effect on 6 April 2020
- **27 February 2020** – Treasury published “Review of changes to the offpayroll working rules: report and conclusions”
- **7 March 2020** – Announcement that implementation would be delayed until 6 April 2021
- **6 April 2021** – Extension of Chapter 10 to services provided to medium and large non-public sector clients

Chapter 8 Part 2 ITEPA 2003

- Still applies to non-public sector clients who are “small” and where the client does not have a “UK connection”:

“Section 49 – Engagements to which this Chapter applies

(1) This Chapter applies where—

(a) an individual (“the worker”) personally performs, or is under an obligation personally to perform, services for another person (“the client”),...

(b) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (“the intermediary”), and

(c) the circumstances are such that—

(i) if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client or the holder of an office under the client, or

(ii) the worker is an office-holder who holds that office under the client and the services relate to the office...”

Chapter 8 Part 2 ITEPA 2003

- Other conditions:

(1) If intermediary is a company – see section 51:

- worker must have a material interest in the company (e.g. beneficial ownership or control of 5% of company); or
- Payments received directly from intermediary can reasonably be taken to represent remuneration for services provided by the worker to the client.

(2) If intermediary is a partnership – see section 52

(3) If intermediary is an individual – see section 53.

Chapter 8 Part 2 ITEPA 2003

- Application of the legislation:

(1) The intermediary (e.g. the personal service company) is treated as making a payment of employment income to the worker

(2) The deemed employment income is the total payments and benefits received by the intermediary (reduced by 5%)

MINUS:

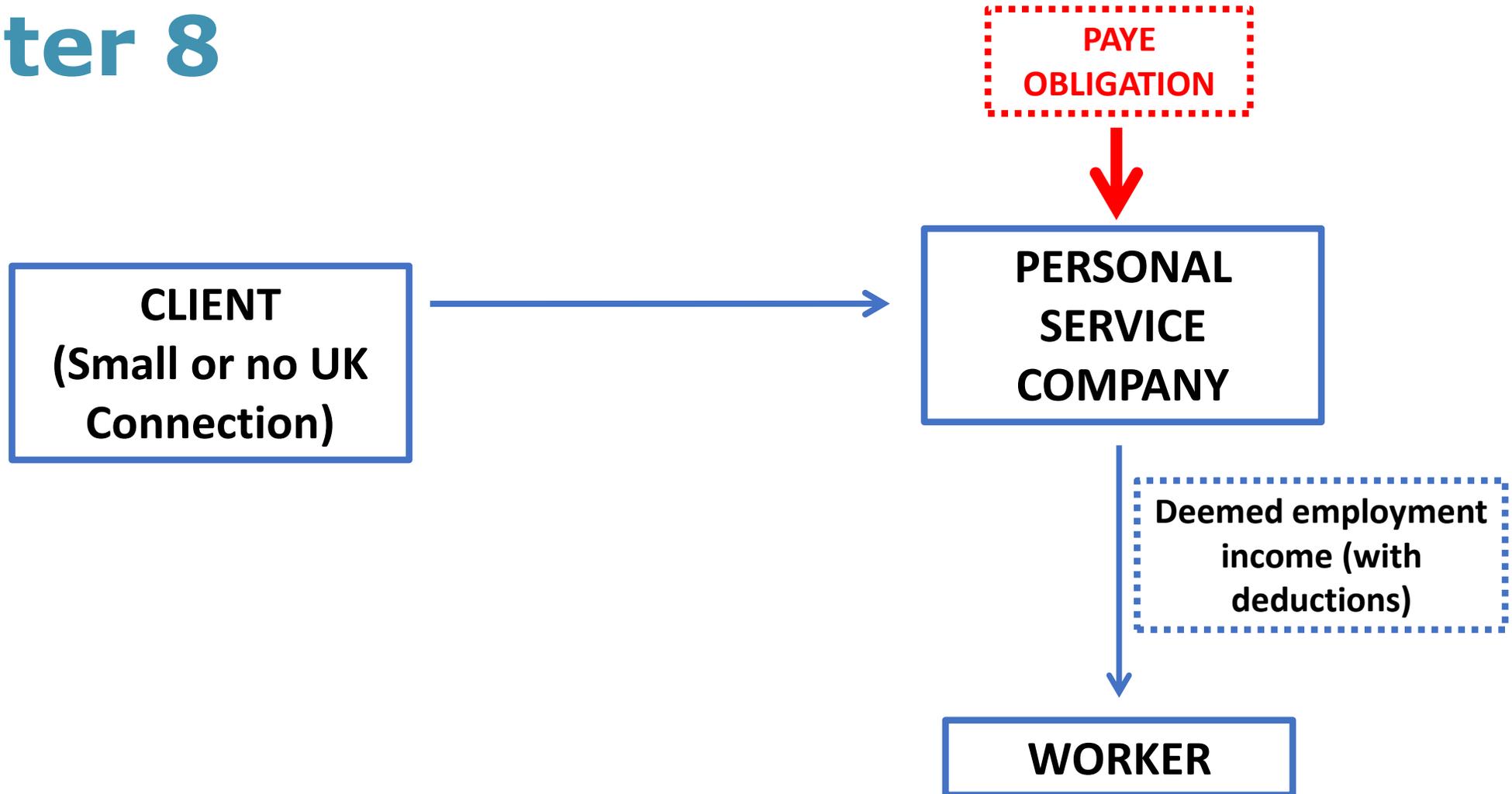
- Expenses and capital allowances that would be allowable if the worker were employed

- Pension contributions

- Employer's NICs

(3) The intermediary can claim relief for any tax paid on distributions (but note time limits)

Chapter 8



Chapter 10 Part 2 ITEPA 2003

- From 2017 applied to public bodies (section 61KL) – as defined by Freedom of Information Act 2000 and Freedom of Information (Scotland) Act 2002.
- Includes government departments (and their executive agencies), companies owned or controlled by the public sector, schools or universities, local authorities, parts of the National Health Service.
- See limitations for ‘primary-healthcare providers’.
- From April 2021, Chapter 10 also applies where the client is medium or large (unless no “UK connection”).

Chapter 10 Part 2 ITEPA 2003

Medium and large clients

- A person is medium or large if it is not small - see sections 60A to 60G, applying Companies Act 2006.
- Unless it is a company's first financial year, the company will be small (within the small companies regime) for the following tax year if, looking at those accounts, it satisfies two of the following requirements:
 - A turnover of not more than £10.2m
 - A balance sheet total of not more than £5.1m
 - Not more than 50 employees
- There similar rules for other undertakings (including individuals) and rules to catch joint ventures and subsidiaries.

Chapter 10 Part 2 ITEPA 2003

“Section 61M – Engagements to which Chapter applies

(1) Sections 61N to 61R apply where—

(a) an individual (“the worker”) personally performs, or is under an obligation personally to perform, services for another person (“the client”),

(c) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (“the intermediary”),

(ca) the client—

(i) is a public authority, or

(ii) is a person who qualifies as medium or large and has a UK connection for one or more tax years during which the arrangements mentioned in paragraph (c) have effect, and

(d) the circumstances are such that—

(i) if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client or the holder of an office under the client, or

(ii) the worker is an office-holder who holds that office under the client and the services relate to the office...”

Chapter 10 Part 2 ITEPA 2003

For the legislation to apply, one of Conditions A – C must apply (similar to Chapter 8).

Where the legislation applies:

- (1) If 'fee-payer' or the client or another person in the payment chain is treated as making a payment that is to be treated as earnings from employment.
- (2) The 'deemed direct payment' is the amount or value of the payment made by the person treated as making the payment.

MINUS:

- The direct cost to the intermediary of materials used in the performance of the services.
- Expenses that would have been deductible if worker were employed.
- Note: The person who is treated as making the 'deemed direct payment' is **NOT** the intermediary, it will be the client or someone else in the payment chain (e.g. a recruitment agency) – and it is that person who is obliged to operate PAYE.

Chapter 10 Part 2 ITEPA 2003

Who is treated as making the payment of earnings?

- The 'fee-payer' is the person who is treated as making a deemed direct payment.
- However, by default, the client is treated as making the payment (s. 61N(5)).
- By giving a status determination statement to the worker, the client can push responsibility down to the lowest 'qualifying person' in the chain (assuming there is a 'qualifying person').
- A 'qualifying person' is a person who has been given the SDS by the person immediately above them in the chain, is resident or has a place of business in the UK and is not owned or controlled by the worker or their associates.
- The SDS that must be given to make a person a 'qualifying person' is the one given by the client to the worker.
- Note that deemed payments made in Chapter 10 are treated as made at the time the 'fee-payer' makes a chain payment.

Payment Chain

Without SDS

**PAYE
OBLIGATION**

Starting amount to calculate the deemed direct payment is £100.



CLIENT

↓ £100

X (e.g. SUBSIDIARY)

↓ £100

Y (e.g. AGENCY)

↓ £90

INTERMEDIARY



WORKER

With SDS

**PAYE
OBLIGATION**

Starting amount to calculate the deemed direct payment is £90.



Status Determination Statements

- A status determination statement is a statement by the client that:
 - states that the client has concluded that the condition in section 61M(1)(d) is met in the case of the engagement and explains the reasons for that conclusion, or
 - states (albeit incorrectly) that the client has concluded that the condition in section 61M(1)(d) is not met in the case of the engagement and explains the reasons for that conclusion.
- But a statement is not a status determination statement if the client fails to take reasonable care in coming to the conclusion mentioned in it.
- The worker or the deemed employer can challenge the SDS. If this happens, the client must within 45 days give reasons for upholding its conclusion or withdraw the SDS and issue a new one.
- If the client fails to respond or to give reasons, the client becomes the 'fee-payer'.

Recovery of Chapter 10 Liabilities

- Section 688AA ITEPA 2003 – regulations may be introduced to provide for the recovery of any amount due under the PAYE Regulations in respect of a ‘deemed direct payment’
- The sum may be recovered from a “relevant person”, being
 - (a) a person who is not the deemed employer who is the highest in the chain; or
 - (b) is the second highest person in that chain and is a qualifying person.

The Income Tax (Pay As You Earn) (Amendment) Regulations 2020 (draft)

Where:

- (a) A regulation 80 determination has become final and conclusive without full payment having been made in 30 days; and
 - (b) An officer of Revenue and Customs considers there is no realistic prospect of recovery of the amount unpaid from the person liable within a reasonable period of time
- Within 24 months HMRC may serve a recovery notice on a ‘relevant person’ and the person must pay within 30 days
 - Right of appeal

The Test – Sections 49(1)(c) and 61M(1)(d)

“the circumstances are such that—

- (i) if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client or the holder of an office under the client, or
- (ii) the worker is an office-holder who holds that office under the client and the services relate to the office...”

“The legislation calls for a two stage exercise. The first is to find the facts as they existed during the period covered by the decision. The facts to be found are those that serve to identify the 'arrangements' involving the intermediary and the circumstances in which those arrangements existed and the nature of the services performed by the 'worker'. The second is to assume that the worker ... was contracted to perform services to the client ... and to determine whether in the light of the facts as found [the worker] would be regarded as [the client's] employee.”

Sir Stephen Oliver QC in *Tilbury Consulting Ltd v Gittins* [2004] STD (SCD) 72 at [6]

Section 49(1)(c)/61M(1)(d) – approach

Modern Approach (e.g. *HMRC v Kickabout Productions Ltd* [2020] UKUT 216 (TCC) at [6]): the Tribunals have further subdivided the approach identified in *Tilbury Consulting v Gittins* to produce a three stage approach:

- Stage One: identify the relevant 'arrangements' involving any intermediary and the circumstances in which those arrangements existed;
- Stage Two: identify the terms of the notional or hypothetical contract between the worker and the client; and
- Stage Three: decide whether the hypothetical contract identified at Stage Two is a contract of employment.

Section 49(1)(c)/61M(1)(d) – Stage One

- Identify all the facts and circumstances.
- Identify and construe the terms of all contracts in the 'chain'.
- Consider the application of Lord Clarke's statement in *Autoclenz v Belcher* [2011] ICR 1157:

“So the relative bargaining power of the parties must be taken into account in deciding whether the terms of any written agreement in truth represent what was agreed and the true agreement will often have to be gleaned from all the circumstances of the case, of which the written agreement is only a part. This may be described as a purposive approach to the problem. If so, I am content with that description.”

Section 49(1)(c)/61M(1)(d) – Stage Two

- Identify the core terms of the hypothetical contract.
- For Chapter 8 and the NICs equivalent the legislative approaches for income tax and NICs are slightly different, although unlikely to lead to different conclusions.
- In *Dragonfly Consultancy Ltd v Revenue and Customs Commissioners* [2008] STC 3030 Judge Hellier described the NIC rules as concerned with a notional contract encapsulating the arrangements and the income tax rules as concerned with a notional contract whose terms would be determined by asking “What would have been agreed?” This was approved by Henderson J in the High Court.
- This has been remedied for the NICs equivalent to Chapter 10, which uses the same test as for income tax.
- In a three-party case, this stage will often be simple, see Park J in *Usetech Ltd v Young* [2004] STC 1671.

Section 49(1)(c)/61M(1)(d) – Stage Three

When is a contract one of employment?

- There is no single definitive test: “No exhaustive list has been compiled ... nor can strict rules be laid down as to the relative weight which the various considerations should carry in particular cases.” *Market Investigations Ltd. v Minister of Social Security* [1969] 2 QB 173
- Nor is it possible to reason by analogy. Vinelott J in *Walls v Sinnett* (1986) 60 TC 150
- What does this leave?

Section 49(1)(c)/61M(1)(d) – Stage Three

A wholistic, impressionistic analysis:

“In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a check list to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another. The process involves painting a picture in each individual case.”

Mummery J in *Hall v Lorimer* [1992] 1 WLR 939, approved by Nolan LJ in the Court of Appeal [1994] 1 WLR 209.

Section 49(1)(c)/61M(1)(d) – Stage Three

The most common 'tests' (1)

Mackenna J. in *Ready Mixed Concrete (South East) Limited v Minister of Pensions & National Insurance* [1968] 1 All ER 433:

“A contract of service exists if the following three conditions are fulfilled:

- (i) The servant agrees that in consideration of a wage or other remuneration he will provide his own work and skill in the performance of some service for his master.
- (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.
- (iii) The other provisions of the contract are consistent with its being a contract of service.”

Section 49(1)(c)/61M(1)(d) – Stage Three

The most common 'tests' (2)

Cooke J in *Market Investigations v Minister of Social Security* [1969] 2 QB 173:

“... the fundamental test to be applied is this: 'Is the person who has engaged himself to perform these services performing them as a person in business on his own account?' ... The most that can be said is that control will no doubt always have to be considered, although it can no longer be regarded as the sole determining factor; and that factors, which may be of importance, are such matters as whether the man performing the services provides his own equipment, whether he hires his own helpers, what degree of financial risk he takes, what degree of responsibility for investment and management he has, and whether and how far he has an opportunity of profiting from sound management in the performance of his task.”

Section 49(1)(c)/61M(1)(d) – Stage Three

Mutuality of Obligation

This may serve one or both of two purposes: (1) where a contract exists at all; (2) “*whether the mutual obligations are sufficiently work-related*”.

Briggs J in *Weight Watchers v HMRC* [2011] UKUT 433 TC

HMRC have argued that the content of the mutual obligations is very limited. The UT found it was rather fuller (see *HMRC v PGMOL* [2020] UKUT 0147 (TCC) at [67]-[70]).

Section 49(1)(c)/61M(1)(d) – Stage Three

Control

- Control is the closest the authorities come to identifying a determinative factor: described in *Ready Mixed Concrete* as necessary but not sufficient with other factors being negative.
- If a genuine contractual right of control to a sufficient degree exists, it does not matter whether that right is actually exercised: *Autoclenz v Belcher*.
- “the test requires that the putative employer has a contractual right to direct the manner in which the worker is to perform their obligations, and that those directions are enforceable, in the sense that there is an effective sanction for their breach” (*PGMOL* at [138]).
- The importance of control will vary with the nature of the work. Control will be much less relevant to highly skilled or specialist work: *Morren v Swinton and Pendlebury BC* [1965] 1 WLR 576.

Section 49(1)(c)/61M(1)(d) – Stage Three

Other factors

- whether the worker must perform the work personally;
- the duration of the contract and amount of time spend working for the client;
- the extent to which the worker is financially dependent on the client;
- whether the worker provides his own equipment and/or materials (and the nature of that equipment);
- whether he hires his own help;
- what degree of financial risk he takes;
- what degree of responsibility for investment and management he has;
- whether and how far he has an opportunity of profiting from sound management in the performance of his task;
- whether he forms 'part and parcel' of the client's business;
- whether he provides services to other clients and whether contract prevents him from doing so; and
- whether the contract provides for holiday and sick pay.

Section 49(1)(c)/61M(1)(d) – Stage Three

Kelly - *Albatel Ltd* [2019] UKFTT 195

- Reasonably long contracts working 42 weeks a year, usually 4 days a week.
- Services as a first class presenter and various additional work.
- Allowed to take other work (overriding terms of written contract)
- Duty to co-operate with ITV but LK could decide the manner, means and methods by which she performs.
- LK decided the running order of the programme.
- LK carried out a variety of other work (e.g. designing a fashion line).
- Services as a first class presenter.
- 10-12 month contracts
- No right of substitution
- Minimum number of shows and entitled to payment if a show cancelled and not rescheduled = mutuality
- Dates and locations contractually determined by ITV (even though decided collaboratively in practice)
- ITV had editorial control over programmes (even though decided collaboratively in practice)
- “a sufficient framework of control”
- No significant expenditure by RWG (agent’s fee disregarded)

IR35 – Chapter 10 – Drafting Points

- Substitution clauses? Is it realistic on the facts? At discretion of intermediary and/or at discretion of client? Does it allow the worker NEVER personally to perform the services?
- The Tribunal will generally consider the terms of the contract as drafted – **NOT** as intended to operate in practice (subject to *Autoclenz* principle). E.g. excessive control – *RWG* at [23(3)].
- Including obligations for worker to provide assistance in determining the IR35 position and in disputes with HMRC.
- Flexibility to deduct – e.g. not based on actual application of the law but on a reasonable application of the law considering CEST and HMRC's Guidance.

IR35 – Chapter 10 – Practical Points

- Shift of risk – from intermediary to the client
- Limiting risk with HMRC:
 - (1) Be conservative
 - (2) Use of agencies and SDSs – shift the liability down the chain (but beware of recovery provisions)
 - (3) Using HMRC's 'Check employment status for tax' online tool – how much protection does this provide?
- Limiting risk with workers:
 - (1) Clauses allowing 'reasonable belief'
 - (2) Limit recourse so that the worker must reclaim from HMRC
 - (3) Do indemnity clauses work? Paragraph 3A, Schedule 1 Social Security Contributions and Benefits Act 1992

IR35 – Chapter 10 – Practical Points

- Increase in net cost of workers with PSCs
 - (1) Employer's NICs in addition to contract price
 - (2) Compliance burden
 - (3) Renegotiation of contracts on 6 April 2021?
- Transition on 6 April 2021:
 - Cashflow issues for workers
 - Historic position – will HMRC go back 4 years?
 - New contracts required?
- Consider bringing workers into more direct contractual arrangements?
- Workers/clients reclaiming overpaid tax/NICs from HMRC

PUMP COURT TAX CHAMBERS

Any questions?
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